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Financing Climate Change Adaptation and Mitigation in Africa: Key Issues and Options for Policy-Makers and Negotiators

Policy Brief

Paper prepared for:

The Third Financing for Development Conference on Climate Change,

Kigali, Rwanda,

21-22 May, 2009

and

The African Ministerial Conference on the Environment (AMCEN) Special Session on Climate Change

Nairobi, Kenya

25-29 May 2009

Financing Climate Change Adaptation and Mitigation in Africa: Key Issues and Options for Policy-makers and Negotiators[1]

I. The Issue

Providing financial support to developing countries to help mitigate the effects of climate change and adapt to its impacts, will be crucial to achieving agreement at the United Nations Framework Convention on Climate Change (UNFCCC) in Copenhagen in December 2009. Several proposals to generate new funds are being put forward to the UNFCCC. This policy brief presents different funding options for consideration and makes recommendations on the way forward.

II. Background

Why is climate change financing crucial for Africa?

Africa contributes less than four percent of the total global greenhouse gas emissions, but it is among the most vulnerable to climate change and has a very low capacity to adapt to its effects. Voluntary contributions by developed countries will not be enough to meet Africa's adaptation needs. This makes climate change financing one of the most important issues in international negotiations.

What are the estimated costs of climate change for developing countries?

Adaptation cost estimates vary between the World Bank's $10-$40 billion in 2020 to the UNDP's 2007 estimate of $86 billion per year in 2015. There is a convergence in the recent cost estimations at around US$100 billion to $200 billion for climate change mitigation.

What resources have been provided by international public financing initiatives?

While not entirely exhaustive, the following table lists multilateral and bilateral funding mechanisms on climate change.

MULTILATERAL FUNDING INITIATIVES	
Name of fund	**Administered by**
Adaptation Fund	Adaptation Fund Board, Kyoto Protocol
Clean Energy Investment Framework	African Development Bank
Congo Basin Forest Fund	African Development Bank
Strategic Priority on Adaptation	Global Environmental Facility
Special Climate Change Fund	Global Environmental Facility
Least Developed Countries Fund	Global Environmental Facility
GEF Trust Fund - Climate Change focal area	Global Environmental Facility
MDG Fund – Environment and Climate Change	UN Development Programme
UN-REDD Programme	UN Development Programme
Pilot Program for Climate Resilience	The World Bank
Scaling-Up Renewable Energy Program	The World Bank
Strategic Climate Fund	The World Bank
Forest Carbon Partnership Facility	The World Bank
Forest Investment Program	The World Bank
Clean Technology Fund	The World Bank

[1] This policy brief is based on a paper of the same title that was commissioned by the United Nations Economic Commission for Africa and the Organization for Economic Cooperation and Development - African Partnership Forum, at the request of the Secretariat of the African Ministerial Conference on the Environment. Jessica Brown of the Overseas Development Institute and Djimingue Nanasta of ENDA Tiers Monde are acknowledged for helping to put together the policy brief

BILATERAL FUNDING INITIATIVES	
Name of fund	**Administered by**
Cool Earth Partnership	Japan
Environmental Transformation Fund	United Kingdom
Global Climate Change Alliance	European Commission
International Climate Initiative	Germany
International Forest Carbon Initiative	Australia

Despite the recent proliferation of international public financing initiatives:

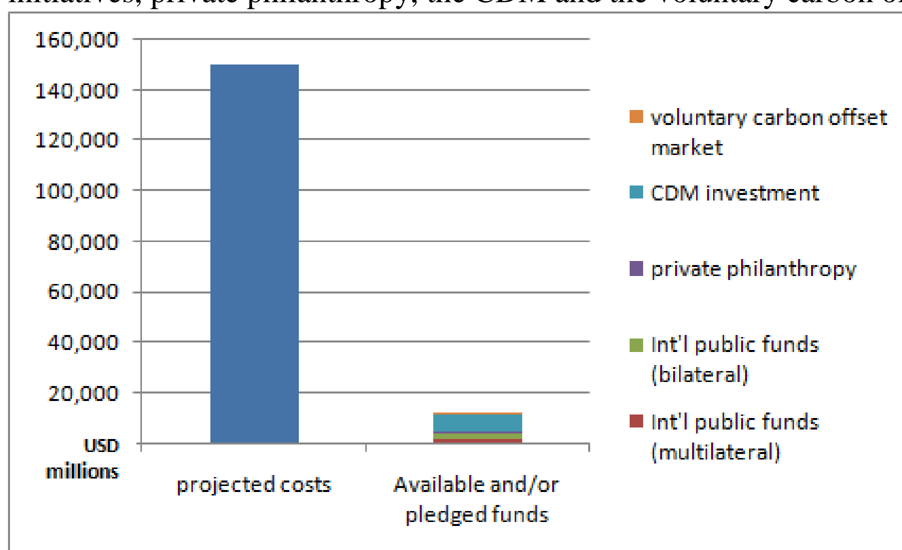
- Almost all international public funds rely on voluntary contributions and will not raise sufficient financial flows needed;
- Developing countries have received a fraction of the money that has been promised to them. Overall, less than 15% of the pledged funds have actually been disbursed;
- Of funds actually disbursed, Africa has received less than 12% in the last four years;
- While hundreds of projects are identified in the 39 National Adaptation Programmes of Action, only three are currently being implemented; and
- Even the praised Adaptation Fund is not yet operational and lacks sufficient funding.

What resources have been provided by the carbon market?

The Clean Development Mechanism (CDM) was established under the Kyoto Protocol and designed to assist Annex I Parties comply with emission reduction commitments and to foster sustainable development in developing countries. As of end-2007, proceeds from the sale of emission credits from CDM projects amounted to $7.4 billion. However, only 17 out of 1186 CDM projects are located in sub-Saharan Africa, most of which (14 out of 17) were located in South Africa. The CDM is currently inadequate as an investment vehicle and mitigation tool for Africa.

How big is the gap between what financial resources are needed and what are available?

The graph below demonstrates the massive gap in available funding for climate change. The graph shows the annual estimated costs against the funding that is currently available from international public funding initiatives, private philanthropy, the CDM and the voluntary carbon offset market.



III. Key principles and concerns for Africa

In accordance with the needs of African nations expressed in Algeria's submission to the UNFCCC in April 2008, the following criteria should be met when creating a future financial mechanism:

- **Adequate**: Recognizing the need to significantly increase the amount of money for mitigation and adaptation, funding, in particular for adaptation, must be massively increased;

- **New and additional:** Any assistance provided by developed countries under climate change needs to be additional to existing Official Development Assistance (ODA);
- **Equitable:** Funding should be in accordance with common but differentiated responsibilities and respective capabilities;
- **Predictable:** Ensuring flows can be sustainable in the long-term;
- **Accountable to the COP:** Ensuring representation is equitable and transparent;
- **'MRV'able:** Finance support should be monitored, reported, and verified (MRV) in order to assess progress in meeting financial obligations under the Convention;
- **Coherence:** In view of the fragmentation of funding currently flowing to Africa, there is need for coherence in the international climate change financial architecture;
- **Direct access:** African countries need direct access to any new funds with minimal management by intermediaries. This would shift the responsibility of decision making to national governments, which aligns with the Paris declaration on aid effectiveness;
- **Address adaptation:** Responding to adaptation is a major priority for African governments; and
- **Appropriate: grants vs. loans debate:** There should be no cost or conditionality attached to adaptation funding.

Specific concerns and priorities for Africa stated above are grounded in key principles and the text of the UNFCCC and Bali Action Plan. Whether and how these principles are met is the central issue of the current international climate change negotiations.

IV. Policy options

What are the key elements of policy options for a future financial mechanism?

Any option for a new financial mechanism should include the following three key functions:

A. **Revenue raising:** specific finance raising mechanism, who pays, and how they pay
B. **Governance:** how the funds are managed, oversight, accountability
C. **Revenue disbursement:** how funds are distributed and used

A. What are the proposals for 'revenue raising' and what needs to be considered when negotiating policy?

A number of parties have proposed options for raising financial resources to address climate change in developing countries. These proposals aim to generate funds through action in the carbon market, carbon or international travel-related taxes, or from conventional ODA. Proposals are organized as follows:

1. Auctioning of assigned amounts or emission allowances;
2. A uniform global levy on CO_2 emissions, with exemption for LDCs;
3. Levies/taxes on emissions from international maritime transport and aviation, or on air travel;
4. A levy on market-based mechanisms under the Kyoto Protocol;
5. Defined budgetary contributions;
6. Hybrids; and
7. Other innovative mechanisms.

1. **Auctions of assigned amounts or emission allowances:** Each Annex I country receives a number of emissions units to release and/or trade (*Assigned Amount Units,* AAUs) in accordance with the Kyoto Protocol. This scheme recommends internationally auctioning a share of AAUs, rather than giving them out for free to domestic firms that seek compliance. This is the basis for the *Norwegian proposal*. Norway estimates this could generate $20-30 billion per annum.

   This proposal is innovative because it involves a degree of autonomy. The money raised is 'non-national' and cannot be traced back to any single Annex I country. The principle of holding back AAUs has been included in the January 2009 EC Communication, and stands a strong chance of

becoming part of the EU's negotiating offer for Copenhagen. This proposal could be combined with the other 'revenue raising' options.

2. **A uniform global levy on CO_2 emissions, with exemption for LDCs:** Under the *Swiss Global Carbon Adaptation Tax*, funds are raised by placing a global tax on all carbon emissions. The revenue for this proposal would be raised according to the 'polluter pays' principle through a uniform global levy on carbon of $2 per tonne of CO_2 on all fossil fuel emissions. This corresponds to a burden of about $0.5 cents per litre of liquid fuel. A free emission level of 1.5 tons of CO_2 per capita would be applied to all countries, creating an exemption for those with extremely low emissions levels (primarily the Least Developed Countries- LDCs).

   This funding mechanism would provide a predictable level of finance. However, since revenues from taxes will first be collected through national treasury, there is a risk that funds will be less predictable than funds generated under truly 'non-national' processes. This proposal has been criticized for using a uniform tax, which does not account for historical emissions. This issue could be addressed by implementing a higher tax rate in countries with greater historic emissions.

3. **Levies/taxes on emissions from international maritime transport and aviation, or on air travel:** funds are raised by charging individuals and companies, based on their responsibility for emissions and/or their capability to pay. The charges or levies could be applied to air travel, aviation emissions, and/or maritime emissions. Proposals include:
   - *International Air Passenger Adaptation Levy* on fuels (IAPAL): IAPAL was proposed by the Maldives on behalf of the Group of Least Developed Countries (LDCs) and recommends that a levy should be a set fee per airline ticket. Fees would be differentiated by class of travel;
   - *International Maritime Emissions Reduction Scheme* (IMERS): A carbon levy is placed on fuel used for carrying cargo to destinations within Annex I countries; and
   - *Tuvalu's Burden Sharing Mechanism*: Funding would be raised through levies on emissions trading and international aviation and maritime transport.
     Specifically, Tuvalu proposes:
     1. A 0.01% levy on international airfares and maritime transport freight charges operated by Annex II countries;
     2. A 0.001% levy on international airfares and maritime transport freight charges operated by non-Annex I countries; and
     3. Exemptions would apply to LDCs and Small Island Developing States (SIDS).

   These proposals are innovative as the funds raised are 'non-national' and cannot easily be traced back to any Annex I country. Funds estimated for the IAPAL and IMERS proposals are likely to be significant and could be combined with other 'revenue raising' options.

   Levies on emissions and taxes on emissions from international maritime and aviation transport may be affected by the global financial slowdown if the downturn leads to a reduction in overall economic activity, which would reduce the revenue coming from such a levy. However, these proposals are likely to be more reliable than proposals that tie the revenue to the price of carbon.

4. **A levy on market-based mechanisms under the Kyoto Protocol**: Funds can be generated by applying a levy to the Kyoto Protocol's tradable units generated from the CDM, JI, or emissions trading. The 2% CDM levy currently in place to raise funds for the Adaptation Fund is an example of a carbon market-based levy. One proposal, supported by South Africa and Costa Rica, is to extend the levy to both JI and emissions trading. This was a hot topic at the December 2008 COP 14 in Poznan, but Parties were unable to reach consensus because countries that host JI projects thought a levy might make the projects more expensive and deter investment.

Based on dead-end discussions in Poznan, this proposal lacks sufficient political support. Moreover, the revenues from carbon market-linked mechanisms are likely to fluctuate, corresponding with the fluctuations in the carbon price. There have recently been sharp drops in the carbon price due to the financial crisis, seen in the price of EU allowance units and CDM and JI credits being sold.

5. **Defined budgetary contributions:** Proposals are based on defined national budgetary contributions. The *G77 plus China proposal*, where developed countries provide funding of 0.5% of GDP, is currently supported by the African Group, and proposes to raise large revenues ($200-400 billion per annum) through Annex I governments' public spending, proposed at 0.5% to 1% of gross national product.

   The G77 plus China proposal sets out to raise the most funds but, given that it is based on national budgetary contributions with the funds passing through a national treasury, the pledges can easily be disrupted by domestic budgetary processes. The proposal has received little support outside the G77, given that many Parties view it as unrealistic because of the scale of the request and the fact that even old promises of ODA have not been met.

6. **Hybrids:** Some proposals recommend a hybrid of funding mechanisms. *Mexico's Green Fund* proposes to create a new fund by raising money from multiple sources, such as budgetary expenditure, tax on air travel, auctioning permits in domestic cap and trade systems, etc. Countries contribute on the basis of emissions, population and income, mainly for mitigation. Funds would range from $10-95 billion for mitigation, $0.2-1.2 billion for adaptation (between 2012-2030). Mexico's proposal has received some positive attention. The EC's recent Communication, apart from mentioning support for the AAU proposal, also refers to a proposal based on Mexico's.

   The Mexican proposal has a few political obstacles. First, it requires contributions from both developed and developing countries. The G77 (African Group included) is resolutely resistant to this. If the requirement of developing country contributions is relaxed, the proposal would likely gain more political support. Second, the proposal strongly prioritizes mitigation funding. Adaptation funding would need to take more precedence. Third, it may be difficult to rely on 'non-national' revenue raising mechanisms for this proposal, given its focus on attributing financial contributions back to individual countries on the basis of emissions, population and income. If budgetary contributions are heavily relied upon, the reliability and adequacy of the funds will be threatened.

7. **Other innovative mechanisms:** The EU's Global Climate Financing Mechanism is not a new fund, but a fundraising mechanism which EU Member States would join on a voluntary basis. Bonds are issued on the international capital markets and proceeds are invested in mitigation and adaptation activities in developing countries. This would enable 'frontloading' of funding for immediate use. Future repayment over a long period (e.g., 20 years) would be financed through revenue of EU Member States derived from the future auctioning of emission rights.

The strength of this proposal is that it avoids imposing costs on consumers and taxpayers, and instead front loads finance through the use of bonds and other debt instruments raised against the guarantee of tax revenue in developed countries to depreciate costs over time. However, given that the GCFM is not a fund but instead a fundraising mechanism which EU Member States would join on a voluntary basis, the funds may be insignificant, unreliable, and unpredictable.

B. What are the policy options for 'governance' and what needs to be considered for negotiations?
Enmeshed in the decision on *how* to generate finance for climate change measures in Africa is the equally tough decision concerning the structure, governance, and allocation of the funds. This discussion centres on different policy options based on two different models: a unified international fund approach versus a more diverse system of multiple financing streams. Parties have proposed the following options for the future financial framework:

(a) Creating new institutional arrangements, including funds; and
(b) Making efficient and effective use of current institutional arrangements;
(c) Reforming the existing institutional arrangements, including financial mechanisms, such as the Global Environment Facility, an operating entity of the Convention, and creating new institutional arrangements including funds.

Non-Annex I Parties, including the African Group and G77, have proposed the creation of a single umbrella body, as an institutional arrangement under the authority of the COP. Many non-Annex I countries want a new Financial Mechanism because:

- The Convention calls for a Financial Mechanism that is under the COP – currently this does not exist. It is not possible for the COP to ensure coordination and coherence amongst mechanisms that are 'outside' the Convention;
- Existing mechanisms do not allow developing countries a 'voice' in the governance; and
- The current institutions cannot raise the scale of financing required.

The African Group emphasized that a central element of stronger climate architecture is full accountability to the COP, as well as direct access and a country driven approach. This implicitly means that the African Group is advocating for a new financial institution. Many Annex I countries are opposed to creating a new financial institution as it risks incurring transaction costs, potentially diminishing the value of the finance raised.

The African Group supports a unified management authority to ensure funding is properly governed. However, even if a new mechanism is created, current institutional arrangements such as the GEF are likely to continue. African negotiators would be well advised to support the reform of existing institutional arrangements as well as the creation of new institutional arrangements – this is a more realistic approach for negotiations given the political leanings of Annex I countries and the state of current financial resources that may continue post-2012.

C. What are the policy options for 'disbursement' and what needs to be considered when negotiating policy?
The main policy options related to disbursement are whether resources should be prioritized for mitigation activities, adaptation activities, or some combination of the two. Another policy option that is likely to come up relates to whether financial resources made available are grant-based or debt-based. All other elements of fund disbursement and use are likely to be considered once the 'revenue raising' and 'governance' models are worked out.

A main priority for Africa is to ensure that adaptation funding is grant-based. African governments have also expressed the need to enhance their absorptive and response capacity to funds. This should be a main focus of the future financial mechanism. African negotiators should continue to support efforts to increase access to funds and ensure equitable distribution.

V. Policy Recommendations

The following policy recommendations relate to domestic actions, and options for a future international financing mechanism.

Policy recommendations for domestic action:

- Build domestic response capacity in order to use current and future funds effectively;

- Create domestic carbon market opportunities by improving the domestic investment framework and build capacities of regional banking institutions, raise awareness and increase support for capacity development; and
- Integrate climate issues into development. Climate change issues need to be integrated into national planning and decision making processes.

Policy recommendations for a future international financing mechanism:

- For international '**governance'** of a future financial mechanism, African negotiators have already agreed on key governance attributes of a proposed financial mechanism governance structure. Based on the political realities of other Parties involved, Africa should support a new institutional structure, managed by the COP, but also bear in mind that other funds are likely to continue.

- For a future international '**revenue raising**' mechanism, Africa should support the international auctioning of AAUs and levies on emissions from international maritime and aviation transport. If Mexican proposal gains traction, negotiators should only consider support provided that developing country financial commitments are relaxed, that such a fund is linked to innovative mechanisms to avoid putting excessive pressure on public financing, and more of the funds are earmarked for adaptation.

- For the **'disbursement and use'** of international funds, Africa should:
  - *Decide how best to position the African Group vis a vis other groups of Annex I and non-Annex I countries in order to continue a strong push for adaptation funding*
  - *Strengthen alliance with other regions supporting adaptation measures, such as AOSIS*
  - *Continue to push for appropriate finance (grant-based) for adaptation*
  - *Continue to push for direct access to funds, equitable allocation of funds*
  - *Continue to push for support on response capacity*

- **General-** African countries must continue to put pressure on developed countries to honour their commitments within the Convention. Pressure on developed countries needs to be consistent in order to ensure financial pledges are delivered. African countries would gain tremendously from allying strongly with one another and with other developing countries.

For further reading and sources, please refer to the technical report on which this policy brief is based, entitled 'Financing Climate Change Adaptation and Mitigation in Africa: Key Issues and Options for Policy-Makers and Negotiators.'